



Thumbnail sketch of the FairTaxSM a comprehensive plan to replace income and payroll taxes

The FairTax proposal is a comprehensive plan to replace federal income and payroll taxes, including personal, gift, estate, capital gains, alternative minimum, Social Security/Medicare, self-employment, and corporate taxes. The FairTax proposal integrates such features as a progressive national retail sales tax, dollar-for-dollar revenue replacement, and a rebate to ensure that no American pays such federal taxes up to the poverty level. Included in the FairTax plan is the repeal of the 16th Amendment to the Constitution. The FairTax allows Americans to keep 100 percent of their paychecks (minus any state income taxes), ends corporate taxes and compliance costs hidden in the retail cost of goods and services, and fully funds the federal government while fulfilling the promise of Social Security and Medicare.

Americans take home their *whole* paychecks.

Not only do more Americans have jobs, but they also take home 100 percent of their paychecks (except where state income taxes apply). No federal income taxes or payroll taxes are withheld from paychecks, pensions, or Social Security checks.

No federal sales tax up to the poverty level means progressivity like today's tax system.

To ensure no American pays tax on necessities, the FairTax plan provides a prepaid, monthly rebate (prebate) for every registered household to cover the consumption tax spent on necessities up to the federal poverty level. This, along with several other features, is how the FairTax completely untaxes the poor, lowers the tax burden on most, while making the overall rate progressive. However, the FairTax is progressive based on lifestyle/spending choices, rather than simply punishing those taxpayers who are successful. Do you see how much freer life is with the FairTax instead of the income tax?

No tax on used goods. The amount you pay to fund the government is totally visible.

With the FairTax you are only taxed once on any good or service, the sales tax is charged just as state sales taxes are today. If you choose to buy *used* goods – used car, used home, used appliances – you do not pay the FairTax. If, as a business owner or farmer, you buy something for strictly business purposes (not for personal consumption), you pay no consumption tax. When you decide what to buy and how much to spend, you see exactly how much you are contributing to the government with each purchase.

Retail prices no longer hide corporate taxes or their compliance costs, which drive up costs for those who can least, afford to pay. Did you know that hidden income taxes and the cost of complying with them currently make up 20 percent or more percent of *all* retail prices? It's true. According to Dr. Dale Jorgenson of Harvard University, hidden income taxes are passed on to the consumer in the form of higher prices – from an average 22 percent on goods to an average 25 percent on services - for everything you buy. If competition does not allow prices to rise, corporations lower labor costs, again hurting those who can least afford to lose their jobs. Finally, if prices are as high as competition allows and labor costs are as low as practical, profits/dividends to shareholders are driven down, thereby hurting retirement savings for moms-and-pops and pension funds invested in Corporate America. With the FairTax, the sham of corporate taxation ends, competition drives prices down, more people in America have jobs, and retirement/pension funds see improved performance.

The income tax exports our jobs, rather than our products. The FairTax brings jobs home.

Most importantly, the FairTax does not burden U.S. exports as they are with the current income tax. So the FairTax allows U.S. exports to sell overseas for prices 22 percent lower, on average, than they do now, with similar profit margins. Lower prices sharply increase demand for U.S. exports, thereby increasing job creation in U.S. manufacturing sectors. At home, imports are subject to the same FairTax rate as domestically produced goods. Not only does the FairTax put U.S. products sold here on the same tax footing as foreign imports, but the dramatic lowering of compliance costs in comparison to other countries' value-added taxes also gives U.S. products a definitive pricing advantage which foreign tax systems cannot match.

The FairTax strategy is revenue neutrality:

Neither raise nor lower taxes so consumer costs remain stable.

The FairTax pays for all current government operations, including Social Security and Medicare. Government revenues are more stable and predictable than with the federal income tax because consumption is a more constant revenue base than is income.

If you were in a 23-percent income tax bracket, the federal government would take \$23 out of your paycheck for every \$100 you made. With the FairTax, if the federal government gets \$23 out of every \$100 spent in America, the same total revenue is delivered to the federal government. This is revenue neutrality. So, instead of paycheck-earning Americans paying 15.3 percent of their paychecks in Social Security/Medicare payroll taxes, plus an average of 18 percent of their paychecks in federal income tax, for a total of about 33 percent, consumers in America pay only \$23 out of every \$100 they choose to spend on *new* goods or services for their own personal consumption. And this tax is collected only on spending above the federal poverty level, providing important progressivity.

Tax criminals – don't make criminals out of honest taxpayers.

Today, the IRS will admit to 25 percent non-compliance with the code. FairTax.org will be generous and simply take the position that this is likely a conservative estimate of the underground economy. However, this does not take into account the criminal/drug/porn economy, which equally conservative estimates put at one trillion dollars of untaxed activity. The FairTax *will* tax this – criminals love to flash that cash at retail – while continuing to provide the federal penalties so effective in bringing such miscreants to justice. The substantial decrease in points of compliance – from every wage earner, investor, and retiree, down to only retailers – also allows enforcement to concentrate on following the money to criminal activity, rather than making potential criminals out of every taxpayer struggling to decipher the current code.

What is Americans For Fair Taxation?

Americans For Fair Taxation (FairTax.org) is a non-profit, non-partisan, grassroots organization dedicated to replacing the current tax systems. The organization has hundreds of thousands of members and volunteers nationwide. Its strategy supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the web page: www.fairtax.org or call 1-800-FAIRTAX.

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FairTax Frequently Asked Questions

1. **What is taxed?** The FairTax is a single-rate, federal retail sales tax collected only once, at the final point of purchase of new goods and services for personal consumption. Used items are not taxed. Business-to-business purchases for the production of goods and services are not taxed. A rebate makes the effective rate progressive.
2. **Exactly what taxes are abolished?** The FairTax is replacement, *not* reform. It replaces federal income taxes including, personal, estate, gift, capital gains, alternative minimum, Social Security, Medicare, self-employment, and corporate taxes.
3. **How does the rebate work?** All valid Social Security cardholders who are U.S. residents receive a monthly rebate equivalent to the FairTax paid on essential goods and services, also known as the poverty level expenditures. The rebate is paid in advance, in equal installments each month. The size of the rebate is determined by the Department of Health & Human Services' poverty level multiplied by the tax rate. This is a well-accepted, long-used poverty-level calculation that includes food, clothing, shelter, transportation, medical care, etc. See chart in Figure 1 below.
4. **Why not just exempt food and medicine from the tax? Wouldn't that be fair and simple?** Exempting items by category is neither fair nor simple. Respected economists have shown that the wealthy spend much more on unprepared food, clothing, housing, and medical care than do the poor. Exempting these goods, as many state sales taxes do, actually gives the wealthy a disproportionate benefit. Also, today these purchases are *not* exempted from federal taxation. The purchase of food, clothing, and medical services is made from *after* income tax and *after* payroll tax dollars, while their purchase price hides the cost of corporate taxes and private sector compliance costs. Finally, exempting one product or service, but not another, opens the door to the army of lobbyists and special interest groups that plague and distort our taxation system today. Those who have the money will send lobbyists to Washington to obtain special tax breaks in their own self-interest. This process causes unfair and inefficient distortions in our economy and must be stopped.

Figure 1: 2004 Rebate calculation for the 48 contiguous states¹

Family size	HHS annual poverty level ²	FairTax annual consumption allowance (single person)	Annual rebate (single person)	Monthly rebate (single person)	FairTax annual consumption allowance (married couple)	Annual rebate (married couple)	Monthly rebate (married couple)
1	\$ 9,310	\$ 9,310	\$2,141	\$178	N/A	N/A	N/A
2	\$12,490	\$12,490	\$2,873	\$239	\$18,620	\$4,283	\$357
3	\$15,670	\$15,670	\$3,604	\$300	\$21,800	\$5,014	\$418
4	\$18,850	\$18,850	\$4,336	\$361	\$24,980	\$5,745	\$479
5	\$22,030	\$22,030	\$5,067	\$422	\$28,160	\$6,477	\$540
6	\$25,210	\$25,210	\$5,798	\$483	\$31,340	\$7,208	\$601
7	\$28,390	\$28,390	\$6,530	\$544	\$34,520	\$7,940	\$662
8	\$31,570	\$31,570	\$7,261	\$605	\$37,700	\$8,671	\$723

¹ Alaska and Hawaii have different poverty levels and different FairTax rebates. See last page of FAQ's.

² Federal Register: Feb. 13, 2004 (Vol. 69, No. 30, pp. 7336-7338)

5. **Is the 23% FairTax revenue-neutral rate higher or lower when compared to income and Social Security taxes people pay today?**

Most people are paying that much or more today – much of it is just hidden from view. The income tax bracket most people fall into is 15 percent, and all wage earners pay 7.65 percent in payroll taxes. That's 23 percent right there, without taking into account the 7.65 percent employer matching! On top of that, you have to add in all of the hidden taxes embedded in the price of everything you buy, from goods (averaging 22 percent) to services (averaging 25 percent).

Effective tax rates vs. stated tax rates

Because the 23-percent FairTax would not be imposed on necessities, an individual spending \$28,808 would pay an effective tax rate of *only* 15.6 percent, *not* 23 percent. That same individual will pay 17.3 percent of his or her income to federal taxes under current law.

6. **Does the FairTax rate need to be much higher to be revenue neutral?**

The proper tax rate has been carefully worked out; 23 percent does the job of: (1) raising the same amount of federal funds as are raised by the current system, (2) paying the universal rebate, and (3) paying the collection fees to retailers and state governments. Unlike some other proposals, several different, non-partisan institutions have independently confirmed this rate across the country. Detailed calculations are available from FairTax.org.

7. **How is the Social Security system affected?**

Like all federal spending programs, Social Security operates exactly as it does today, except that its funds come from a broad, progressive sales tax, rather than a narrow, regressive payroll tax. Employers will continue to report wages for each employee, though, to the Social Security Administration for the determination of benefits. The

transition to a reformed Social Security system will be eased while ensuring there is sufficient funding to continue promised benefits. Meanwhile, Social Security/Medicare funds will no longer be triple-taxed as they are now: 1) when payroll taxes are initially withheld; 2) when those withheld payroll taxes are counted as part of the taxable base for income tax purposes; and 3) when the promised benefits are finally received.

8. **How does the FairTax affect Social Security reform?** FairTax.org is a one-issue organization: Tax replacement. However, its proposal does benefit *any* Social Security reform proposal. The FairTax.org plan does not change Social Security benefits or the structure of the Social Security system. All it does is replace the current revenue source (narrow, regressive payroll taxes) with a new revenue source (broad, progressive sales taxes paid by all consumers).

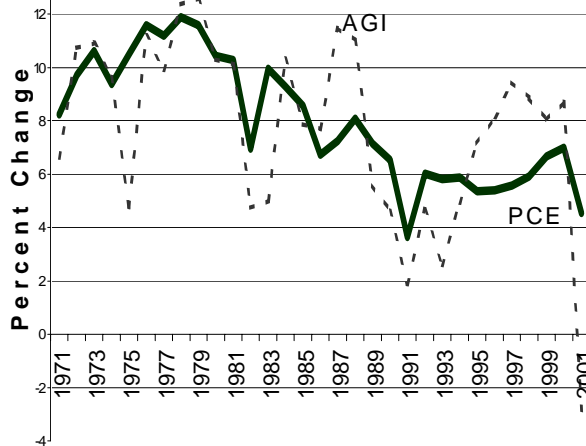
Additionally, research shows that consumption is a more stable revenue source than income. If Social Security is reformed or privatized in a way that reduces the government's need for revenue, then the FairTax rate can be reduced. For example, if a mandatory private savings program is implemented where people must save 10 percent of their income and Social Security benefits are curtailed, then the FairTax rate can be reduced just as payroll taxes would be reduced.

9. **Is consumption a reliable source of revenue?**

Yes, in fact, consumption is a more stable source of revenue than income. A recent study by American Farm Bureau economist Ross Korves shows the FairTax base was less variable than the income tax base. Why? Because during difficult times due to loss of a job or an inability to work, people may not have as much income, or may have no income at all. They borrow funds or use savings. They may not have earnings, but they still continue to consume. Korves' Figure 2 below shows the yearly changes in the tax base, adjusted gross income (AGI),

under the current tax system for 1971-2001 and changes in personal consumption expenditures (PCE) of the same time period.

10. **Figure 2: Stability of the tax base⁴ 1971 to 2001**



10. **How is the tax collected?** Retail businesses collect the tax from the consumer, just as state sales tax systems already do in 45 states; the FairTax will simply be an additional line on the current sales tax reporting form. Retailers simply collect the tax and send it to the state taxing authority. All businesses serving as collection agents will receive a fee for collection, and the states will also receive a collection fee. The tax revenues from the states will then be sent to the U.S. Treasury.

11. **Why is the FairTax better than our current system?** Our present tax system is one of the reasons that people are finding it so difficult to get ahead these days. It is one of the reasons the next generation may not have a standard of living as high as this generation. Cars replaced the horse and buggy, the telephone replaced the telegraph, and the FairTax replaces the income tax. The income tax is holding us back and making it more difficult than it needs to be to improve our families' standard of living. It makes it needlessly difficult for our businesses to compete in international markets. It wastes

vast resources on complying with needless paperwork. We can do better and we must.

12. **Is the FairTax fair?** Yes, the FairTax is fair, and in fact, much fairer than the income tax. Wealthy people spend more money than other individuals. They buy expensive cars, big houses, and yachts. They buy filet mignon instead of hamburger, fine wine instead of beer, designer dresses and expensive jewelry. The FairTax taxes them on these purchases. If, however, they use their money to build job-creating factories, finance research and development to create new products, or fund charitable activities (all of which help improve the standard of living of others), then those activities are not taxed.

13. **How does the FairTax protect low-income and lower middle-income-families and individuals?** Under the FairTax plan, poor people pay no net FairTax at all up to the poverty level! Every household receives a rebate that is equal to the FairTax paid on essential goods and services, and wage earners are no longer subject to the most regressive and burdensome tax of all, the payroll tax. Those spending at twice the poverty level will pay a tax of only 11.5 percent – a rate much lower than the income and payroll tax burden they bear today.

Under the federal income tax, slow economic growth and recessions have a disproportionately adverse impact on lower income families. Breadwinners in these families are more likely to lose their jobs, are less likely to have the resources to weather bad economic times, and are more in need of the initial employment opportunities that a dynamic, growing economy provides. Retaining the present tax system makes economic progress needlessly slow, thus harming low-income people the most.

In contrast, the FairTax dramatically improves economic growth and wage rates for all, but especially for lower income families and individuals. In addition to receiving the monthly FairTax rebate, these taxpayers are freed from regressive payroll taxes, the federal income tax, and the compliance

⁴ Korves, Ross; senior economist, "An Economic View of the FairTax Proposal," American Farm Bureau Federation, December 1, 2003.

burdens associated with each. They pay no more hidden taxes on goods (averaging 22 percent) or services (averaging 25 percent), and used goods are tax-free.

14. **Is it fair for rich people to get the exact same FairTax rebate from the federal government as the poorest person in America?** Let's look at a billionaire under the FairTax – if he spends \$10,000,000 dollars he pays a tax of \$2,300,000 and gets a rebate of \$4,283 (assuming he is married and has no children). His effective tax rate is 22.96 percent.

Now, let's look at a middle-income married couple, under the FairTax, with no children – if they *spend* \$40,000, they pay \$4,917 net of their rebate for an effective tax rate of 12.3 percent. The effective tax rate increases as spending increases, but *never* exceeds 23 percent!

Figure 3: Comparison of effective tax rates

	FairTax	Income tax
Expenditures = income	\$40,000	\$40,000
Net tax	\$4,917	\$6,005
Effective tax rate	12.3%	15.0%

In contrast, this same couple, if they *earn* \$40,000 in wages today under the income tax, pays \$3,060 in payroll taxes and \$2,945 in income taxes for a total of \$6,005 in taxes (15.0 percent).

In addition, their employer pays another \$3,060 in payroll taxes. Most economists agree that the employer payroll tax is actually borne by employees in the form of lower wages. Looked at this way, this couple is paying \$9,065 (22.6 percent) in taxes today, which doesn't even include the hidden taxes they pay every time they make a purchase. Therefore, a middle-income married couple with no children has an effective FairTax rate of 12.3 percent, compared to their effective income tax rate of 22.6 percent!

Finally, let's look at a low-income couple under the FairTax – *they pay no net*

FairTax at all. Today, under the income tax system, they not only pay 15 percent in payroll taxes, but they also pay hidden taxes – arising from corporate taxes, private sector compliance costs, and payroll taxes passed on to consumers and embedded in the price of everything they buy, from goods (averaging 22 percent) to services (averaging 25 percent).

15. **What about senior citizens, retired people, and anyone on a fixed income?** As a group, seniors do very well under the FairTax. Low-income seniors are much better off under the FairTax than under the current income tax system.

Some erroneously believe that people who live exclusively on Social Security pay no taxes. They may not know it, but with corporate income taxes, they are paying hidden taxes averaging 22 percent (for goods) to 25 percent (for services) on everything they buy. Under the FairTax, they break even from the very beginning because they only pay \$0.23 out of every dollar they *choose to spend* on new goods and services, rather than anywhere from 20 to 30 percent in hidden taxes. And note, they elect to pay these taxes through their lifestyle choices.

It gets better from there. Seniors, like everyone else, receive a monthly rebate, in advance of purchases, for taxes paid on the cost of necessities. If seniors choose to work, they are freed from regressive payroll taxes, the federal income tax on wages, and the compliance burdens associated with each. They pay no more hidden taxes on goods or services, and used goods are tax-free. There is no income tax on their Social Security benefits.

The income tax imposed on investment income and pension benefits or IRA withdrawals is repealed. Pension funds, IRAs, and 401(k) plans had assets of \$6.5 trillion in 1994. An income tax deduction was taken for contributions to most of these plans. All beneficiaries and owners of these plans expected to pay income tax on them upon withdrawal, but will not be required to do so under the FairTax.

All owners of existing homes experience

large capital gains due to the repeal of the income tax and implementation of the FairTax plan. Seniors have dramatically higher home ownership rates than other age groups (81 percent for seniors compared to 65 percent on average). Homes are often a family's largest asset. Gains are likely to be in the range of 20 percent.

The FairTax makes the economy much more dynamic and prosperous. Consequently, federal tax revenues grow. This makes it less likely that federal budget pressures require Medicare or Social Security benefit cuts.

16. **How does the FairTax help seniors who have paid taxes on their retirement savings or invested in Roth IRAs?** As a general rule, tax/title/license/drive-out prices will change little, if any, under the FairTax. Simply put, the FairTax is a revenue-neutral proposal, raising no more money than does the current system. The FairTax only changes where the money is raised, not the amount. Because the FairTax is a zero-sum proposal, it is also translates to price neutrality.

Additionally, some erroneously believe that people who have invested in Roth IRAs will never pay taxes on this money again. They may not know it, but with corporate income taxes, they are paying hidden taxes averaging 22 percent (for goods) to 25 percent (for services) on everything they buy. Under the FairTax, they break even from the very beginning because they only pay only \$0.23 out of every dollar they *choose to spend* on new goods and services, rather than anywhere from 20 to 30 percent in hidden taxes. And note, they elect to pay these taxes through their lifestyle choices.

When corporate income taxes are repealed, pre-tax prices can come down an average of 22 percent for goods and 25 percent for services according to Dale Jorgenson, Ph.D., former chairman of the Harvard University Economics Department. Furthermore, used goods are not taxed because they have already been taxed once – when they were new. Therefore senior citizens, like all Americans, do not lose purchasing power, but gain it instead.

Government benefits are maintained. Seniors receive a monthly rebate so they don't pay taxes on the purchase of necessities. Tax-deferred investments get a one-time windfall. Savings invested in any long-term, income-generating asset such as a stock, real estate, or a long-term bond that can't be called, will increase substantially in value. Finally, complex estate planning is an artifact of an earlier age.

17. **How much do pre-tax prices for goods and services go down under the FairTax?** All goods and services already contain the embedded costs of the current tax system in their prices. When these embedded taxes are removed, prices come down. Dale Jorgenson, Ph.D., former chairman of the Economics Department at Harvard University, has projected an average producer price reduction of 22 percent for goods and 25 percent for services in just the first year after the adoption of the FairTax. In addition, the FairTax lowers compliance costs by an estimated 95 percent and the removal of these costs will force prices down even lower.
18. **Should the government tax medicine and health care?** Because federal income and payroll taxes are embedded in the price of everything you buy, you are *already* paying federal taxes on the drugs and other health care services that you buy today – they are just hidden. After passage of the FairTax, prices (even including the FairTax) may not go up at all. Harvard economist Dale Jorgenson estimates that the pre-tax prices of services will decline by 25 percent because of the repeal of the income tax.
19. **Should the government tax services?** Service providers are not exempt from the income tax today, and should not be exempt from the FairTax. Services now account for well over one-half of the gross domestic product (GDP). Neither consumption of services nor consumption of goods should be tax preferred. And it is economically foolish not to tax the fastest growing segment of our economy. Competition, not politics, should determine what goods and services cost.

- 20. How does the FairTax affect income tax preparers, accountants, and many government employees?** There will, of course, still be some people who are involved in sales tax return preparation and sales tax administration under the FairTax, but many fewer than those involved with the income tax today. Those tax preparers, tax lawyers, and Internal Revenue Service employees, who are typically well educated and well equipped with transferable skills, will have to find other, more productive work. The projected 10.5 percent growth in the economy during the first year of the FairTax will provide plenty of new jobs. But the heavy compliance costs of the income tax are like an anchor holding back economic growth. *We have nothing to show for the \$250 billion (three Iraq wars worth) that we spend each year measuring, tracking, sheltering, documenting, and filing our annual income.* Surely these valuable labor and capital resources can be employed more productively – for example, in following the money trails left by terrorist, drug, and other criminal enterprises, rather than in tracking *every* American wage earner.
- 21. What about the home mortgage deduction?** The FairTax has positive effects on residential real estate far beyond this narrow question. Today's homeowners, if they itemize (and 70% do not), pay their interest with post-Social Security/pre-income tax dollars. They then pay their principal with post-SS/post-income tax dollars. Those who do not itemize get no advantages at all. Under the FairTax, *all* homeowners make their *entire house* payment with pre-tax dollars. With the FairTax, mortgage interest rates fall by about 25 percent (about 1.75 points) as bank overhead falls; this is a huge savings for consumers. For example, on a \$150,000, thirty-year home mortgage at an interest rate of 7.00 percent, the monthly mortgage payment would be \$999.12. On that same mortgage at a 5.25 percent interest rate, the monthly payment would be \$830.01. Over 30 years, the 1.75-percent decrease in interest rates in this instance would result in a \$60,879

cost savings to the consumer.

Finally, first-time buyers save for that down payment much faster, as savings are not taxed.

Under the FairTax, home ownership is a possibility for many who have never had that option under the income tax system. Lower interest rates, the repeal of the income tax, the repeal of *all* payroll taxes, and the rebate mean that people have more money to spend, and have an increased opportunity to become homeowners.

- 22. What will happen to charitable giving?** Charitable contributions depend on one factor more than any other: The health of the economy (*not* tax benefits). As a wide range of economists agrees on the economic expansion the FairTax delivers, charitable contributions benefit also. For all of the money that pours into churches every Sunday and into a broad range of charities every day, only the 30 percent who itemize get any tax benefit. The other 70 percent have given and keep giving with no *tax* benefit whatsoever.

The FairTax allows people to make charitable contributions out of *pre-tax dollars*. Thus those generally less affluent taxpayers who do not itemize see their cost of charitable giving go down under the FairTax.

Finally, the wealthy make decisions on charitable giving based on the cause. Once they have determined the cause is worthy, their contribution is structured to maximize the gift and minimize the tax. But the intention to give comes first; taxes simply determine the structure – rarely the amount – of the gift.

- 23. Will corporations get a windfall with the abolition of the corporate tax?** Corporations are legal fictions that have not, do not, and never will bear the burden of taxation. Only people pay taxes. Corporations pass on their tax burden in the form of higher prices to consumers, lower wages to workers, and/or lower returns to investors. The idea that taxing a corporation reduces taxes on, say the working poor, is a cruel hoax. A corporate tax only makes what

the working poor buy more expensive, costs them jobs, lowers their lifestyle, or delays their retirement. Under the FairTax plan, money retained in the business and reinvested to create jobs, build factories, or develop new technologies, pays no tax. This is the most honest, fair, *productive* tax system possible. Free market competition will do the rest.

24. **Does the FairTax burden the retail industry?** All businesses are tax collectors today. They withhold income and payroll taxes from their employees. Moreover, the vast majority of retail businesses operating in states with a sales tax (45 states currently use a sales tax) are already sales tax collectors. Under the FairTax, retailers are paid a fee equal to one-quarter of one percent of federal sales tax they collect and remit. In addition, of course, retailers no longer bear the cost of complying with the income tax, including the uniform capitalization requirements, the various depreciation schemes, and the various employee benefit and pension rules. Finally, because of the economic growth resulting from the aggregate, beneficial effects of dramatically lower income tax compliance costs and no payroll or income taxes, customers will have substantially more money – the greatest influence on retail sales – and a reasonable fee for collecting the FairTax, all ensure that retailers will do quite well.
25. **How are state tax systems affected, and can states adequately collect a federal sales tax?** No state is required to repeal its income tax or piggyback its sales tax on the federal tax. All states have the opportunity to collect the FairTax; states will find it beneficial to conform their sales tax to the federal tax. Most states will probably choose to conform. It makes the administrative costs of businesses in that state much lower. The state is paid a ¼ of one percent fee by the federal government to collect the tax. For states that already collect a sales tax, this fee proves generous. A state can choose not to collect the federal sales tax, and either outsource the collection to another state, or opt to have the federal government collect it directly. If a

state chooses to conform to the federal tax base, they will raise the same amount of state sales tax with a lower tax rate – in some cases more than 50 percent lower – since the FairTax base is broader than their current tax base. States may also consider the reduction or elimination of property taxes by keeping their sales tax rate at or near where it is currently. Finally, conforming states that are part of the FairTax system will find collection of sales tax on Internet and mail-order retail sales greatly simplified.

26. **How will the plan affect economic growth?** With the penalty for working harder and producing more removed, Americans are free to keep every dollar they earn, and a new era of economic growth and job creation is unleashed. Hidden taxes are history, Americans are able to save more, and businesses invest more. Capital formation, the real source of job creation and innovation, is facilitated. Gross domestic product (GDP) increases by an estimated 10.5 percent in the first year alone. The FairTax as proposed raises the economy's capital stock by 42 percent, its labor supply by four percent, its output by 12 percent, and its real wage rate by eight percent.

As U.S. companies and individuals repatriate, on a tax-free basis, income generated overseas, huge amounts of new capital flood into the United States. With such a huge capital supply, real interest rates remain low. Additionally, other international investors will seek to invest here to avoid taxes on income in their own countries, thereby further spurring the growth of our own economy.

27. **What economic changes come at the retail level with the FairTax?** Our baby boom generation has been trained to spend money before inflation eats it up or savings is taxed away. This group, for good or evil, will likely spend their initial pay raise. Others will recognize the advantages of savings and investment. There will be a whole new round of home refinancings. There will likely be a lot of interest in the actual cost of the federal

government when consumers see their most recent contribution at the bottom of each retail receipt.

Since the FairTax plan is *revenue neutral*, the same amount of resources is extracted from the economy as is extracted under current law. These funds are, however, extracted in a less economically damaging way. Every known economic projection shows the economy doing better, often much better, under the FairTax.

Because the economy grows, is more efficient, and more productive, while investment, wages and consumption are higher than they are under the income tax.

28. **What happens to interest rates?** First, interest rates drop quickly by approximately one-quarter. Interest rates include compensation to the lender for the tax that they must pay on interest you pay them. That is why taxable bonds bear a higher interest rate than tax-exempt bonds. When the tax on interest is removed, interest rates will drop toward today's tax-exempt rate.
- Second, under the current system, savings and investments are taxed. Under the FairTax, savings and investments are not be taxed at all. As Americans save more money, the pool of funds in lending institutions grows. When you add to this the flood of capital currently trapped offshore, we realize a huge increase in the pool of capital, thereby causing the cost of borrowing funds to drop.
29. **What happens to the stock market, mutual funds, and retirement funds?** Investors prosper greatly under this plan, since corporations face lower operating costs and individuals have more money to save and invest. The reform significantly enhances the retirement savings and/or retirement spending power of most Americans.
30. **What happens to tax-free bonds?** Tax-free bonds are still tax-free, though they are now directly competitive with corporate bonds. Under the FairTax equities, treasuries, bonds, and other investments are all tax-free. There is a one-time windfall in non-callable instruments, such as corporate bonds; this

windfall also has a positive effect on callable instruments with some time remaining to the call date, including treasuries.

31. **How does this affect U.S. competitiveness in foreign trade?** Since all U.S. exporters immediately see an average 20-percent reduction in their production costs, they experience an immediate boost in their competitiveness overseas. American companies doing business internationally are able to sell their goods at lower prices but similar margins, and this brings jobs to America.

In addition, U.S. companies with investments or plants abroad will bring home overseas profits without the penalty of paying income taxes, thus resulting in more U.S. capital investment.

And at last, imports and domestic production are on a level playing field. Exported goods *are not* subject to the FairTax, since they are not consumed in the U.S.; but imported goods sold in the U.S. *are* subject to the FairTax because these products are consumed domestically.

32. **What about border issues?** It is unlikely that "shopping across the border" in Canada or Mexico will result in any cost savings to the consumer. Remember, the FairTax is revenue neutral and therefore price neutral. This means the final cost of retail goods and services after the FairTax remains very close to the same levels found in the marketplace today. With regard to interstate competition, since all states have the same federal sales tax rate, the federal sales tax is not an incentive to cross state lines to avoid the tax.
33. **Does the FairTax improve compliance and reduce evasion when compared to the current income tax?** The old aphorism that nothing is certain except death and taxes should be modified to *include* tax evasion. Tax evasion is chronic under any system so complex as to be incomprehensible. As a percentage of gross domestic product (GDP), tax evasion is beyond 2.0 percent, compared to 1.6 percent in 1991. Tax evasion continues to be in the range of one quarter of income

taxes collected. Almost 40 percent of the public, according to the IRS, is out of compliance with the present tax system, mostly unintentionally due to the enormous complexity of the present system. These IRS figures *do not* include taxes lost on illegal sources of income with a criminal economy estimated at a *trillion dollars*. All this, despite a major enforcement effort and assessment of tens of millions of civil penalties on American taxpayers in an effort to force compliance with the tax system. Disrespect for the tax system and the law has reached dangerous levels and makes a system based on taxpayer self-assessment less and less viable.

The FairTax reduces rather than increases the problem of tax evasion. The increased fairness, transparency, and legitimacy of the system will induce more compliance. The roughly 90-percent reduction in filers enables tax administrators more narrowly and effectively to address non-compliance and increases the likelihood of tax evasion discovery. The relative simplicity of the FairTax promotes compliance. Businesses need answer only one question to determine the tax due: *How much was sold to consumers?* Finally, because tax rates decrease, tax evasion is less profitable; and because of the dramatic reduction in the number of tax filers, tax evaders are be more easily monitored and caught under the FairTax system.

34. Can the FairTax really be passed into law?

Do women have the right to vote in this country? Did we pass Prohibition? Did we repeal it? Do Blacks enjoy freedoms far beyond the lunch counter and mass transit? Do free-market economies dominate Eastern Europe, peoples once under the boot of communism? All these were grassroots efforts that effected significant changes in our nation and the world. Is the current income tax system any less a yoke around the necks of otherwise free peoples? We think not.

Passing the original 16th Amendment and the income tax wasn't easy and repealing the income tax and the 16th Amendment won't be

easy either. That is why the FairTax has undertaken to build a grassroots movement and grassroots alliances to support the effort. When the FairTax generates unprecedented economic growth in the first few months of its effective date, citizens nationwide will make it clear to Washington that they want to make the change permanent. But this will only happen when the American people rally behind the effort, throw off the yoke, and demand rectification of ninety years of wrongs done by the income tax.

35. What other significant economies use such a tax plan? Two of the largest economies in the world rely almost solely on sales taxes: Florida and Texas. Many civilizations in history have relied solely on transaction-based consumption taxes: A percentage of a grain shipment in exchange for a safe harbor. Even a cursory study of history shows that nation/states that relied on consumption taxes flourished and prospered, supported democracies/republics, had expanding economies, and high levels of civil rights for their citizens. The exact opposite is true for empires that relied on income/poll/head taxes. These taxes were used to support despots, eventually collapsed the economies in which they were applied, and sundered civil rights.

The sales tax is a familiar tax, being a major source of revenue in 45 states and the District of Columbia. It is true, however, that no post-industrial nation, until now, has ever *repealed* its income tax and *replaced* it with a federal retail sales tax. However, England did repeal its detested income tax upon the defeat of Napoleon and enjoyed the fastest, longest expansion of its economy in its long history. An expansion that ended only with the – you guessed it – re-imposition of an income tax.

No other country has a system of government like ours, and no other country has led the world in so many fields as ours. It was France and Germany that forced the imposition of a VAT *in addition to* income taxes across the European Community. Shall we follow France's lead? In contrast, we can observe the Irish Miracle that stems from their refusal to join the EC and their choice to

follow their own path on taxation. Thus, we should simply strive to have the best tax system, period.

36. **What about the flat tax? Would it be better and easier to pass?** The flat tax and the FairTax share some important similarities. They are both flat-rate taxes that are neutral with respect to savings and investment. The flat tax, however, retains the invasive income tax administration apparatus and can easily revert to a graduated, convoluted mess, as it has many times over many years.

Very few people really understand the flat tax. Its authors will tell you it is a consumption tax that uses the income tax system for implementation. Only an academic or government bureaucrat would dream up a consumption tax that needs the invasive income tax apparatus for its application, when one can simply have a retail sales tax and reduce the bureaucracy by 90 percent or more! In addition, a large part of the burden of the flat tax – the business tax – will remain hidden from people in the retail price of goods and services.

In contrast, the FairTax is simple, easy to understand, and visible. It cannot be converted into an income tax.

Under a flat tax, individuals would still file an income tax return each year similar to today's 1040 EZ. While this is a simple postcard, the record keeping required to fill in the blanks is still long and burdensome. Under the FairTax, individuals would never file a tax return again, ever! Under the flat tax, the payroll tax would be retained and income tax withholding would still be with us. Under the FairTax, the payroll tax, which is a larger and more regressive tax burden for most Americans than is the income tax, would be repealed. Under the FairTax, what you earn is what you keep. No more withholding taxes; no more income tax.

Notwithstanding flat tax proponents' honorable intentions, income tax reform has been less than a success in the past. Congress has tried to reform the income tax again and again, with the result being greater complexity and, generally, higher rates. The problem is

the income tax, and it is time to stop tinkering with it.

Flat tax supporters have made major political attempts to pass their reform, including the efforts of former Majority Leader Dick Armey and presidential candidate Steve Forbes, and yet, their efforts have not progressed politically for several years. With every debate, the flat tax loses grassroots and congressional support to the FairTax. It is time to junk the entire income tax system and start over with a tax system that is more appropriate for a free society and better able to meet the needs of the information age.

37. **Can Congress just simply raise the rate once the FairTax is passed into law?** Yes, of course Congress can raise the FairTax rate just as it could raise the flat tax rate or can and does raise the income tax rate. And if we in the grassroots allow them to do it, shame on us!

However, the FairTax is highly visible. And because there is only one tax rate, it will be very hard for Congress to adopt the typical divide-and-conquer, hide-and-disguise, strategy employed today to ratchet up the burden gradually, by manipulating the income tax code. Ultimately, the tax rate will be dictated by the size of government. If government gets larger, higher tax rates will be required. If government shrinks relative to the economy, then the tax rate will fall. *Federalist 21*, by Alexander Hamilton, is a great read on the futility of government raising a consumption tax too high, and thus reducing revenues.

38. **Could we end up with both the FairTax and an income tax?** No current supporter of the FairTax would support the FairTax unless the entire income tax is repealed. Moreover, concurrent with the repeal of the income tax, a constitutional amendment repealing the 16th Amendment and prohibiting an income tax will be pushed through Congress for ratification by the states.

39. **Is the FairTax just another conservative tax scheme? Or just another liberal tax scheme?** The FairTax has non-partisan support from people in all walks of life. From both major parties and several third parties. Its supporters need only have one common belief: That it is a fairer, simpler, more efficient way to raise federal revenue. The FairTax delivers these benefits to all American people and more. More government accountability for taxpayer dollars, a tax system that is less susceptible to being manipulated by special interests, a tax system that will make it easier – not harder – for the average person to get ahead, and perhaps most importantly, a tax system that provides real, honest, and transparent tax relief for those who need it most.
40. **What assumptions have been made about government spending?** The FairTax plan is devised to be revenue neutral for the first year of operation. It raises the same amount of revenue as is raised by current law. After the first year, revenue is expected to rise because of the growth generated by this plan. At that time the American people, the Congress, and the President will have to decide whether to lower the tax rate, or to spend the additional revenue.
41. **How does the FairTax affect government spending?** The public must remain vigilant to ensure that the economic gains caused by the FairTax benefit the people and the causes they deem worthy. However, it is easier to determine if your elected representatives are acting in your best interest. Legislators can more easily be held accountable for their decisions. For the first time in decades, it is simple to see whether a politician is advocating an increase in taxes or a restraint on government spending as the economic pie gets bigger. This is not the case today.
42. **Why is it necessary to have a constitutional amendment?** It is not the intention of this plan, or the desire of the American people, to end up with both a federal income tax and a federal sales tax. The objective is to ensure that one is replaced by the other, not added on top of the other. By repealing the 16th Amendment, we close the door on an income tax for generations to come.
43. **How does the income tax affect our economy?** How does dragging an anchor affect the speed of a ship? Our entire economy is *not* dependent on the income tax. Instead our economy is held back by the income tax. There was no income tax for the first 124 years of our history – that's more than half the time we have existed as a nation. Under the FairTax, within ten years, average Americans will be at least 10 percent and probably 15 percent better off than they would be under the current system. That translates to an increase of \$3,000 to \$4,500 per household, per year.
44. **How will this plan affect compliance costs?** It is estimated that Americans spend at least \$250 billion a year to comply with the tax code – that's \$850 for every man, woman, and child in America. That is the cost of three Iraq wars. Billions of dollars in compliance costs are wasted each year, and we have nothing of value to show for this expenditure – not one single productive service or product is added to our nation's wealth. It is estimated that the FairTax dramatically cuts such compliance costs, perhaps as much as 95 percent.
45. **What about value-added taxes (VATs), like they have in Europe and Canada? Are they not consumption taxes?** While VATs are also consumption taxes, and better than income taxes, the FairTax is not a VAT. A VAT works very differently. It taxes every stage of production. It is much more complex, and is typically hidden from the retail consumer. Second, in industrialized countries that have a VAT, it coexists with high-rate income tax, payroll and many other taxes that, in some instances, have led to marginal tax rates as high as 70 percent. Third, all other industrialized countries, except Australia and Japan, have a much larger tax burden than the U.S., which requires higher rates and makes tax administration much more difficult. Lastly, a

VAT is a lobbyist's dream, allowing them to install their loopholes unbeknownst to the purchaser. A retail sales tax, in contrast, is a lobbyist's nightmare, applied as it is under the bright lights of the retail counter.

46. What will we experience in the transition from the income tax to the FairTax?

Everyone will have to think about taxes in a different way. Income – what we earn – will no longer have to be documented, measured and kept-track-of for tax purposes. The only relevant measure of our tax liability will be the amount we choose to spend on final, discretionary consumption. Tax-related issues will suddenly be a lot simpler and more straightforward than they used to be.

The aggravation and anxiety associated with “April 15th” will disappear forever after passage of the FairTax. The FairTax is not new – most Americans come into contact with such taxes daily, since 45 states currently use them to collect state revenues. It is easier to switch from an income tax to the FairTax system than it is to switch from gallons to liters, or from feet to meters! Of course, those who depend on the structure and complexity of our current system (e.g., tax lobbyists, tax preparers, and tax shelter promoters) will have to find more productive economic pursuits. However, everyone will have enough advance notice to adjust to the new system.

Job creation will boom. Residential real estate will boom. Financial services will boom. Exports will boom. Retail will prosper. Farming and ranching will prosper. Churches and charities will prosper. Civil liberties will be enhanced. In short, it is difficult to imagine the far-reaching, positive effects of this change. Though this tax

policy is exactly what our Founding Fathers counseled us to do with the *Federalist Papers* and the Constitution.

47. I know the FairTax rate is 23 percent when compared to current income and Social Security rate quotes. What will the rate of the sales tax be at the retail counter?

30 percent. This issue is often confusing, so we explain more here.

When income tax rates are quoted, economists call that a *tax-inclusive* quote: “I paid 23 percent last year.” For every \$100 earned, \$23 went to Uncle Sam. Or, “I had to make \$130 to have \$100 to spend.” That’s a 23-percent *tax-inclusive* rate.

Figure 4: 23-percent tax-inclusive vs. 30-percent tax-exclusive

Quoting a tax-inclusive rate vs. quoting a tax-exclusive rate

The rates are *stated* differently, but the taxes you *pay* are identical.

Income taxes are quoted *tax-inclusive*.

			Your income	Gov't
<u>You earn</u>	<u>You keep</u>		<u>tax rate</u>	<u>keeps</u>
\$100	\$77		23%	\$23
Sales taxes are quoted tax-exclusive.				
		Choose to	FairTax	Gov't
<u>You earn</u>	<u>You keep</u>	<u>spend</u>	<u>rate</u>	<u>gets</u>
\$100	\$100	\$77	30%	\$23

We choose to compare the FairTax to income taxes, quoting the rate the same way, because the FairTax replaces such taxes. That rate is 23 percent.

Sales taxes, on the other hand, are generally quoted *tax-exclusive*: “I bought a \$77 shirt and had to pay that same \$23 in sales tax. This is a 30-percent sales tax.” Or, “I spent a dollar, 77¢ for the product and 23¢ in tax.” This rate, when programmed into a point-of-purchase terminal, is 30 percent.

Note that no matter which way it is quoted, the amount of tax is the same. Under an income tax rate of 23 percent, you have to

earn \$130 to spend \$100.

Spend that same \$100 under a sales tax, you pay that same tax of \$30, and the rate is quoted as 30 percent.

Perhaps the biggest difference between the two is that under the income tax, controlling the amount of tax you pay is a complex nightmare. Under the FairTax, you may simply choose not to spend, or to spend less.

48. Is the FairTax progressive? Do the rich pay more and the poor pay less as a percentage of their spending?

Absolutely, as you can see in Figure 4 below – where the graph shows annual expenditures for a family of four and the corresponding FairTax effective tax rates. The poor actually pay less than zero-percent retail sales tax on their spending. Much like with the earned income tax credit of today, the rebate may give them more money than they actually spend on retail taxes. Especially if they are frugal and buy mostly used products. On the other hand, the wealthy approach a maximum of 23-percent retail sales tax on their spending.

Figure 5: Annual expenditures vs. FairTax effective tax rates, for a family of four

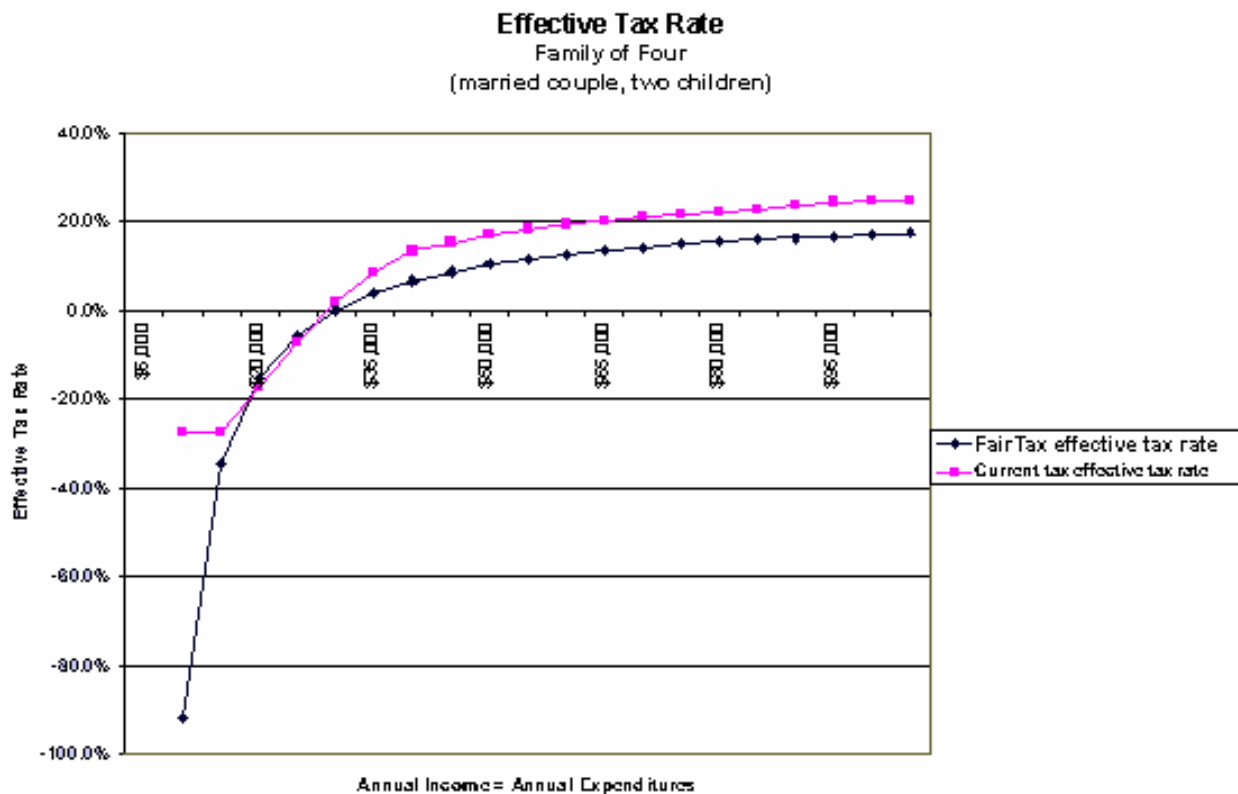


Figure 6: 2004 rebate calculations for Alaska

Family size	HHS annual poverty level ⁵	FairTax annual consumption allowance (single person)	Annual rebate (single person)	Monthly rebate (single person)	FairTax annual consumption allowance (married couple)	Annual rebate (married couple)	Monthly rebate (married couple)
1	\$11,630	\$11,630	\$2,675	\$223	N/A	N/A	N/A
2	\$15,610	\$15,610	\$3,590	\$299	\$23,260	\$ 5,350	\$446
3	\$19,590	\$19,590	\$4,506	\$375	\$27,240	\$ 6,265	\$522
4	\$23,570	\$23,570	\$5,421	\$452	\$31,220	\$ 7,181	\$598
5	\$27,550	\$27,550	\$6,337	\$528	\$35,200	\$ 8,096	\$675
6	\$31,530	\$31,530	\$7,252	\$604	\$39,180	\$ 9,011	\$751
7	\$35,510	\$35,510	\$8,167	\$681	\$43,160	\$ 9,927	\$827
8	\$39,490	\$39,490	\$9,083	\$757	\$47,140	\$10,842	\$904

Figure 7: 2004 rebate calculations for Hawaii

Family size	HHS annual poverty level ⁶	FairTax annual consumption allowance (single person)	Annual rebate (single person)	Monthly rebate (single person)	FairTax annual consumption allowance (married couple)	Annual rebate (married couple)	Monthly rebate (married couple)
1	\$10,700	\$10,700	\$2,461	\$205	N/A	N/A	N/A
2	\$14,360	\$14,360	\$3,303	\$275	\$21,400	\$4,922	\$410
3	\$18,020	\$18,020	\$4,145	\$345	\$25,060	\$5,764	\$480
4	\$21,680	\$21,680	\$4,986	\$416	\$28,720	\$6,606	\$550
5	\$25,340	\$25,340	\$5,828	\$486	\$32,380	\$7,447	\$621
6	\$29,000	\$29,000	\$6,670	\$556	\$36,040	\$8,289	\$691
7	\$32,660	\$32,660	\$7,512	\$626	\$39,700	\$9,131	\$761
8	\$36,320	\$36,320	\$8,354	\$696	\$43,360	\$9,973	\$831

What is the FairTax?

The FairTax is a non-partisan proposal (HR 25/S 1493) that abolishes all federal income taxes, including personal, gift, estate, capital gains, alternative minimum, Social Security/Medicare, self-employment, and corporate taxes, and replaces them all with one simple, visible, federal retail sales tax. The FairTax dramatically changes the basis for taxation by eliminating the root of the problem: Taxing income. The FairTax taxes us only on what we choose to spend, not on what we earn. It does not raise any more or less revenue; it is designed to be revenue neutral. The FairTax is a fair, efficient, and intelligent solution to the frustration and inequity of our current tax system.

What is FairTax.org?

FairTax.org is a non-profit, non-partisan, grassroots organization dedicated to replacing the current tax. The organization has hundreds of thousands of members and volunteers nationwide. Its plan supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the web page, www.fairtax.org, or call 1-800-FAIRTAX.

⁵ Federal Register: Feb. 13, 2004 (Vol. 69, No. 30, pp. 7336-7338)

⁶ Federal Register: Feb. 13, 2004 (Vol. 69, No. 30, pp. 7336-7338)

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